EMPLOYMENT BY CLIENTS OF FORMER CPAS FROM DIFFERENT NON AUDIT SERVICES DEPARTMENTS ON AUDITOR INDEPENDENCE

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Abstract

It is not uncommon for auditors to accept employment with their clients upon leaving their audit firm, but regulators have expressed concerns that this may impair auditor independence. The purpose of this study is to examine the perceptions of Hong Kong "Big 4" CPAs and the fund managers (users) of the impact of the employment by clients of former CPAs from different non audit services (NASs) departments on auditor independence. The time lapse between a CPA leaving the audit firm and taking up employment with a former client is also examined. To cover the most important issues and gaps in the literature, two within-subjects independent variables – types of NASs departments and the time-lapse factor – and one between-subject independent variable – "Big 4" CPAs versus users – are examined. This Hong Kong research is the first study to encompass these variables in a study in the post-Enron environment. A mixed ANOVA was employed to analyse the perceptions of 235 "Big 4" CPAs and 185 fund managers (users). Results show that former CPAs coming from different NASs departments have an influence on perceptions of auditor independence. However, the direction of the relationship may be positive or negative. The results show that former CPAs coming from compliance services and risk management departments enhance perceptions of independence whereas transaction services (due diligence) and corporate finance departments undermine independence. This study does *support* the earlier finding that NASs may increase the value of the auditor to the client (Goldman and Barlev, 1974; Gul, 1989). Second, the longer the lapse of time between a CPA departing from the audit firm and joining the audit client was, the greater the perceived auditor independence was. An interval of one year seems to be a reasonable time for independence to be preserved. Third, there is an interaction effect between the time-lapse factor and the types of NASs departments on perceptions of independence. When the time lapse between a CPA leaving the audit firm and joining the client is less than one year, audit clients should be restricted from employing CPAs from the transaction services (due diligence) and corporate finance departments of the audit firm. Finally, there are significant differences in the overall perceptions of auditor independence held by the CPA and users groups, with the CPA group ratings being higher for all types of services provided and all time lapse intervals. It may be the *expectation gap* that results in this difference in perception, but further research is needed to validate this theory.

Keywords: employment with audit clients, auditor independence, non audit services, expectation gap

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Introduction

The independence of external auditors has long been a subject of great debate, particularly among interested parties in the United Kingdom and the United States. More recently, auditor independence has been questioned with increasing frequency in the media. The relationship between auditors and their clients can create closeness with management that may adversely affect an auditor's independence, thus reducing the quality of an audit. The U.S. Sarbanes Oxley Act was enacted specifically to improve this aspect of auditor independence following the Enron incident. Other conflicts arise from employment relationships with audit clients, and thus the employment of CPAs by their former audit clients has been a focus of regulators and professional bodies for a number of years. The research results concerning whether the hiring by former audit clients of employees from their audit firm jeopardizes auditor independence are mixed (Imhoff, 1978; Koh and Mahathevan, 1993; Iyer and Raghunandan, 2002; Wright and Booker, 2005). The purpose of this paper is to examine an empirical study of the perceptions of

Big 4 CPAs and the users of financial statements of the independence of CPAs who subsequently find employment with former clients. The framework of the study is formed by the identification of gaps in the literature and recent controversial issues. A review of the literature reveals the most appropriate within-subject repeat measure variables to be 1) types of NASs departments, and 2) the lapse of time between a CPA's departure from the audit firm and their employment with the former audit client. This study examines four common types of NASs departments, namely, 1) compliance services 2) risk management, 3) corporate finance services, and 4) transaction services (due diligence). According to a survey by the Hong Kong Institute of Certified Public Accountants (HKICPA, 2007), these services are the most popular non audit services offered by CPA firms to clients in Hong Kong, and thus other services, such as executive search or IT consultancy, are not considered. One between-subject independent variable is examined, namely, "Big 4" CPAs versus users, and the dependent variable is their perception of auditor independence. The ratings of these groups of several independence scenarios set out in a questionnaire relating to CPAs seeking employment with former audit clients are measured. This study is specifically motivated by the Enron incident in the United States, which has had large repercussions on the auditing profession worldwide, although researchers were examining this hot topic some years previously (Imhoff, 1978; Koh and Mahathevan, 1993; Iyer and Raghunandan, 2002; Wright and Booker, 2005). The U.S. Securities and Exchange Commission (SEC) has stipulated a one-year cooling off period before a member of an audit team can work for the client in certain key management positions, but the research results on the impact of this ruling are mixed. This study aims to determine whether this ruling would be applicable in the Hong Kong auditing environment. In Hong Kong, there are currently no mandatory auditing standards to prohibit auditors working for their clients, nor is any cooling-off period suggested. This study is thus the *first* to examine the independence problem as it relates to the practices of CPAs in Hong Kong. Whether the results in Hong Kong are similar to or different from those of previous Western studies encompassing the same three variables is unknown: the different cultural environment in Hong Kong may lead to different outcomes. Vogel (1992) finds that business ethics are particularly affected by cultural contexts, as perceptions of right versus wrong, justice, morality, and perceived auditor independence may differ very much across countries (Patel and Psaros, 2000; Umar and Anandarajan, 2004). Pioneering cross cultural research has found that culture impacts ethical perceptions (Cohen *et al.*, 1995; Brody *et al.*, 1999; Chiu, 2002), and Yang and Sonmez (2007) find that culture affects business ethics. For example, in examining violations of intellectual property (IP) law and the Western ethical principles that assign ownership to IP, Yang and Sonmez (2007) find that most Asian countries, which are under the influence of Confucian ethics, perceive IP to be a communal good and copying as a legitimate means of learning and sharing. Zhang and Zhang (2006) provide a framework for understanding why the propensity to whistle-blow may be different in a Chinese cultural environment. Likewise, the ethical judgment of Chinese CPAs is negatively affected by *guanxi* (Au and Wong, 2000). Cooper *et al.* (2006) find that auditors in the Asia-Pacific region in general – where Confucian culture is prominent – have different perceptions from their Western counterparts, and will thus presumably behave differently in response to organizational stimuli. Cooper *et al.* (1996) find that Hong Kong internal auditors are more concerned with internal controls and less concerned with the efficiency and effectiveness of management than their Australian counterparts. The claimed impact of cultural differences on commercial behavior and the perceived cultural differences between Hong Kong in the Asia-Pacific region and Anglo-American commercial environments justify this research (Agacer and Doupnik, 1991; Patel and Psaros, 2000), and the results will undeniably make a contribution to the literature on auditor independence in the Asia-Pacific region, in addition to assisting policy makers to design policies that improve auditor independence and ethics.

Motivations for employment of former CPAs from Big 4

It is common in Hong Kong for auditors to be offered employment with client firms in senior management positions such as finance director or controller, especially in the current booming employment market (Arens *et al.*, 2007). The auditor in charge of an audit or NASs assignment has the advantage of becoming familiar with the client's operations and business problems, and also amasses vast experience of the company's financial information, which any competitors for the management position will not have. There are often potential benefits for the client firm in hiring a former auditor (Beasley *et al.*, 2000; Wright and Booker, 2005). In a survey by the Hong Kong Institute of Certified Public Accountants (HKICPA), more than 50% of the top management of audit clients had had previous experience with the audit firm (HKICPA, 2007). Client companies prefer to employ former auditors because they typically possess several attractive attributes. Undoubtedly, the training and experiences to which they have been exposed in various industries during their time with the audit firm prove valuable. In addition, the Big 4 firms try to hire the best-performing students from the top business schools, and hence the qualities of their recruits are to a certain extent guaranteed. Beasley *et al.* (2000) suggest that former auditors are intimately familiar with the financial systems and internal control of their clients and of industry peculiarities.

Such knowledge helps them to work effectively with former clients and become part of the management team. Moreover, the client firm has been able to observe the auditor over a period of years during past audits or NASs assignments, thus giving it first-hand knowledge of the auditor's personality, work ethic, and other individual traits. This allows the firm to judge whether the auditor is likely to represent a "good fit" within its corporate culture and environment.

However, there are at least three potential threats to the integrity of the financial reporting process that may result from employing a former auditor in the audit client's team (Beasley *et al.*, 2000). One of these threats arises before the employee's decision to leave the audit firm to join the audit client, and the other two arise after the former auditor has joined the client. The first threat is that professional auditors may compromise their independence to gain employment with the client. This means that an auditor who is considering employment opportunities with a client may exhibit a lack of due diligence in auditing his or her future employer's financial statements. This lack of due diligence may manifest itself either as a failure to gather sufficient audit evidence, or improper acquiescence to the client's preferences for certain accounting principles or audit judgments. Although auditors are required to observe the relevant auditing standards in the audit process, there is some motivation for auditors to sidestep the appropriate levels of due diligence to ingratiate themselves with the current management of the client firm for the purpose of securing an employment position, hence compromising their independence.

The second and third threats arise once the former auditor has joined the client firm's management team. Beasley *et al.* (2000) comment that there is concern that audit firms are less likely to detect financial reporting problems in subsequent audits once a former employee has joined the client. The first reason is that the remaining members of the audit team may be reluctant to question their former colleague, especially if the former auditor previously supervised the current audit or NASs team. Beasley *et al.* (2000) suggest that the current audit team may rely overly on their trust of the former auditor and may fail to exercise the typical level of professionalism required in an audit. Imhoff (1978) also questions whether an auditor can act independently in dealing with a member of the client's management who was previously his or her supervisor on the audit. The second reason is that the former auditor will have a detailed understanding of the audit firm's plan and procedures from when he or she was in the audit team, and could use this knowledge to circumvent the effectiveness of the audit (Arens *et al.*, 2007) or to design a misstatement that is unlikely to be detected by his or her former colleagues (Beasley *et al.*, 2000).

The Hong Kong auditing profession

The HKICPA is the only statutory body in Hong Kong that oversees the work of auditors. Auditors in Hong Kong must follow and comply with the Hong Kong Standards on Auditing (HKSAs) when performing statutory audits, and all audits must be carried by CPAs who have passed all of the professional examinations and have at least four years' experience in the auditing industry. Partners and reporting auditors also need to have a valid CPA practicing certificate issued by the HKICPA when they sign off audit reports. The certificate is renewed annually subject to there being no disciplinary action or other proceedings being reviewed by the HKICPA regarding the auditor in question. In Hong Kong, the Big 4 accounting firms employ the largest number of CPAs in the industry (HKICPA, 2007), as their client numbers are large and their client base is diverse. All of the reporting auditors of the Hong Kong blue-chip companies listed on the Hong Kong Stock Exchange are from the Big 4 audit firms (HKEX, 2008).

Literature on the provision of non-audit services

Through a review of literature, scant research has been conducted on the impact of the employment by clients of former auditors *from different non audit services (NASs) departments* on auditor independence. Hence, the importance of this issue thus justifies the selection of the NASs variable in this study. At the centre of the auditor independence issue is the perceived danger that auditors will not undertake their tasks with independence in circumstances in which they offer both audit and non-audit services (NASs) to their clients. In 2000, Enron reported that it had paid Arthur Andersen \$52 million: \$25 million for audit work and \$27 million for non-audit services (Quick and Rasmussen, 2005). It was alleged that this had impaired Arthur Andersen's independence. Those circumstances fuelled the ongoing debate on the extent to which auditors should be allowed to provide non-audit services to audit clients in the current competitive audit environment. Clearly influenced by the collapse of Enron, the U.S. government enacted the Sarbanes Oxley Act in 2002, which contains provisions prohibiting auditing firms from providing certain non-audit services to audit clients. Section 201(g) prohibits audit firms from providing non-audit services contemporaneously with an audit, and Section 201(g) point 9 allows the Public Company Accounting Oversight Board (PCAOB) to ban any other services that it deems inappropriate. These prohibitions represent significant interventions in the audit market, yet they have not been supported by systematic research (Kinney *et al.*, 2004; Asare *et al.*, 2005). Indeed, some research argues that the provision of non-audit services does not compromise auditor independence due to the potential possibility of litigation, reputation costs, and disciplinary proceedings from the accounting bodies and regulators (Reynolds and Francis, 2001; DeFond *et al*., 2002; Ashbaugh *et al*., 2003). Whether or not the provision of NASs impairs auditor independence is the focus of a growing body of auditing research, and the question is of critical importance in the ongoing debate about the appropriateness of the NASs provided by accounting firms (Larcker and Richardson, 2004). The following table summarizes the findings of previous studies that address the NASs variable.

Table 1. Summary of single-country studies of perceptions of auditor independence (PAI)

Author and Year	Country	Sample type	Survey design	Factors investigated	Results
Imhoff (1978)	US	Big 4 CPAs and users	Mail survey	Time lapse factor, auditor's rank	Time lapse (less than 6 months) between auditing and working for a client firm impairs PAI.
Shockley (1981)	US	Big 8 partners, financial analysts	Mail questionnaire	Competition, non-audit services (NASs), audit firm size, tenure	NASs and competition impair PAI.
Dykxhoorn, and Sinning (1982).	Germany	Financial statement users	Mail survey	Financial decisions	Perceived independence is impaired
Gul (1989)	New Zealand	Bank officers	Mail Survey	Audit committee, client financial condition, NASs, competition, audit firm size	NASs and competition have a significant *positive* impact on PAI.
Koh and Mahathevan (1993)	Singapore	Managers	Distributed in MBA class	Time lapse factor, current position	The shorter the time lapse, the greater PAI is questioned.
Bartlett (1993)	US	Auditors, loan officers	Mail questionnaire	Size of client, NAS, audit client relationship	Provision of NASs perceived by CPAs to *enhance* PAI.
Teoh and Lim (1996)	Malaysia	Auditors	Mail survey	NASs, audit committee, audit firm rotation.	Size of audit fees explained most of the variation.
Beattie *et al.* (1999)	UK	Auditors, finance directors	Mail questionnaire	Economic dependence, competition, NASs, laxity of regulatory framework	The principal threats to independence are economic dependence and NASs.
Hussey and Lan (2001)	UK	Finance Director	Mail questionnaire	Value of audit, impact of the audit, audit client relationship	NASs and rotation of auditors may affect PAI.
Jenkins and Krawczyk (2001)	US	Auditors	Questionnaire	NASs	NASs favorably *enhance* PAI.
Iyer and Raghunandan (2002)	US	Big 4 CPAs	Mail questionnaire	Time lapse factor, gender, rank	No relationship between time-lapse factor and PAI.
Kinney *et al.* (2004)	US	Financial reports in database from 1995-2000.	Firms filed the restated financial statements	NASs, taxation services, restatement of financial statements	No association between unspecified NASs and financial reporting quality.
Lindberg and Beck (2004)	US	Auditors	Mail survey	NASs	Perceptions of impact of NASs on auditor

					independence are more negative after Enron.
Chien and Chen (2005)	Taiwan	Auditors	Mail survey	NASs, audit firm size	NASs negatively influence PAI.
Quick and Rasmussen (2005)	Denmark	Auditors	Mail survey	NASs	The provision of NASs *does not* have an influence on auditor independence.
Alleyne *et al.* (2006)	Barbados	Auditors	Mail survey	NASs, competition, economic environment	NASs and competition negatively influence independence
Carey *et al.*, (2006)	Australia	Directors of listed companies	Mail survey	NASs such as internal audit outsourcing	Directors acknowledge NAS provision affects auditor independence.
Chin *et al.* (2007)	Taiwan	Financial reports in database from 2002-2003	Taiwan economic database	Non-audit fees	Provision of NASs impairs auditor independence.
Basioudis *et al.*, (2008)	UK	Database data	Database	Non-audit fees	High non audit fees impair auditor independence

In view of the conflicting literature relating to NASs and auditor independence, especially in the post-Enron period (Kinney *et al.*, 2004), Raghunandan (2003) and Larcker and Richardson (2004) conclude that further research is justified**.** Few studies have been conducted on the *types of services* provided by auditors that are likely jeopardize auditor independence, and specifically the types of services that *compromise or improve* independence, especially in cases in which a CPA seeks employment with a former audit client. Iyer and Raghunandan (2002) suggest further research needs to be conducted to analyze the types of services mostly likely to affect independence. As no research has been carried out in Hong Kong, this seems to be a good setting for research into the Asian auditing environment. Through a review of literature, scant research has been conducted on the impact of the employment by clients of former auditors *from different non audit services (NASs) departments* on auditor independence**,** the alternative hypothesis H1 is proposed.

H1: *Former auditors from different NASs departments have an influence on perceptions of auditor independence*.

Literature on the time-lapse factor

After the Enron incident, the U.S. SEC stipulated a one-year cooling off period before a member of an audit team can work for a client in certain key management positions. A recent survey conducted by Michael Page International reported that 61 per cent of employers in Hong Kong intended to increase their headcount within the next 12 months and preferred to recruit professionals from the Big 4 accounting firms in so doing (SCMP, 2008). In view of this recruitment trend in Hong Kong and the emphasis that the SEC places on this issue, the selection of the time-lapse variable is justified. Further, previous studies that examine the impact of the time-lapse factor on auditor independence are few in number. In the early literature, Imhoff (1978) finds that both users and CPAs are less likely to question auditor independence when the interval between working on an audit and accepting employment with the audit client increases or when the former auditor worked in a non-supervisory position. Imhoff (1978) also finds a great percentage difference in the perception of independence between users and CPAs in situations where a former audit supervisor accepts employment with a former audit client within six months of the audit being completed. Similarly, Koh and Mahathevan (1993) find that concerns about independence increase as the interval between the last audit and accepting employment with the client decrease. Thus, gaining employment with clients appears to tarnish perceptions of auditor independence, especially when the time lapse between the last audit and accepting employment is small (Imhoff, 1978; Koh and Mahathevan, 1993; Wright and Booker, 2005). However, Iyer and Raghunandan (2002) find no relationship between the time-lapse factor and employment with clients and independence, although with a statistical p value of 0.287, which is not significant. They suggest further research to validate their result. Umar and Anandarajan (2004) agree that many of the previous studies have concentrated on auditors in the United States, rather than other non-English-speaking countries, and that it is insufficient to perform such research only on one country in the current business environment in which multinational companies and international audit firms operate globally. As there are conflicting results in the literature and no research on the matter has been conducted in Hong Kong, there is good reason not only to examine the issue in the Hong Kong context, but also to focus on the distinct groups of CPAs and users (Imhoff, 1978; Umar and Anandarajan, 2004). Alternative hypothesis H2 is proposed.

H2: *The time-lapse factor has an influence on perceptions of auditor independence.*

To determine the interaction effects between the independent variables of the former auditors coming from different NASs departments and the time-lapse factor, the alternative hypothesis H3 is proposed.

H3: *The influence of former auditors coming from different NASs departments on perceptions of auditor independence depends on the time-lapse factor (interaction effect).*

Between-subjects independent variables: types of sample groups

Jenkins and Krawczyk (2001) comment that the perceptions of professional CPAs from Big 4 firms are important because they are the only audit practitioners who audit the financial statements of large and commercially consequential companies. However, if CPAs are themselves uncertain about the observance of independence, then it must be questioned how they can be expected to devise mechanisms to assure independence in the audit procedures and processes that they employ. Thus, the Big 4 CPAs are suitable for selection as a sample group in this study. Moreover, given the emergence of multidisciplinary accounting practices in the Big 4 firms (Frank *et al*., 2001) and the ever-changing competitive audit market (Beattie *et al*., 1999), a study of the perceptions of CPAs of their own independence should provide constructive feedback for regulators. The feedback and results received from such an enquiry could be communicated to the local audit and accounting bodies, such as the HKICPA, which could then direct the opinions of the Hong Kong auditors to the Hong Kong regulators or international accounting bodies to assist them with their accounting and audit policy decisions.

As independence "in appearance," or perceived independence, refers to others' perceptions of auditor independence. Since fund managers would rely on the audited financial statements very often in their work, this group of users is chosen as the second sample group in this study (Firth, 1980; Dykxhoorn and Sinning, 1982). Firth (1980) argues that if an auditor is not seen to be independent, then users will have less confidence in the financial statements the auditor produces. Arens *et al.* (2007) concur that even where auditors are independent in fact, if users believe the auditors to be the advocates of client, then most of the value of the audit function is lost. Thus, the credibility of auditors depends not only on the facts but also, and just as importantly, on the appearance of independence. Clearly, both actual and perceived auditor independence are critical elements in the auditing profession (Pany and Reckers, 1980). As the respondents in previous research include CPAs and users of financial statements, such as bankers and financial analysts (Imhoff, 1978; Firth, 1980; Iyer and Raghunandan, 2002; Wright and Booker, 2005), this Hong Kong study includes a CPA group versus users group as the between-subject independent variable in the mixed ANOVA. The alternative hypothesis H4 is formed to examine the interaction effect between the time-lapse factor and the type of sample group.

H4*: The influence of the time-lapse factor on perceptions of auditor independence depends on the sample group.*

H5 is proposed to determine the interaction effect between the former auditors coming from different NASs departments and the type of sample group.

H5*: The influence of the former auditors coming from different NASs departments on perceptions of auditor independence depends on the sample group.*

The final hypothesis is formed to examine whether there are differences in the perceptions of independence relating to the issue of employment by a former client held by the Big 4 CPA group and the fund managers group.

H6*: There are differences in the perceptions held by the Big 4 CPA group and the users group of auditor independence.*

Data collection method and administration procedure

A quantitative approach was used in the research. Stage one involved a pilot test of the questionnaire that was sent to 10 CPAs and 10 financial statement users who agreed to participate. The participants were randomly selected from the Directory of HKCPAs and Directory of Investment Fund managers which are publicly accessible. The results of the pilot study provided feedback to the researcher (Teoh and Lim, 1996) about the questionnaire, and no ambiguity or problems were found.

Stage two was the survey stage. Given the large population involved, survey mail questionnaires were used (Desira and Baldacchino, 2005). The Big 4 CPAs and users (fund managers) sample were randomly chosen from the Directory of HKCPAs and Directory of Investment Fund managers (Dijk, 2000), which covers a wide geographical area from Hong Kong side to Kowloon side, and thus the use of an anonymous mail questionnaire was deemed to be the most appropriate method (Beattie *et al.*, 1999; Iyer and Raghunandan, 2002). The scenario questionnaire is included in Appendix 1, and is adapted from Pany and Reckers (1987), Knapp (1985), Gul (1989), and Patel and Psaros (2000). Three hundred and fifty auditors and fund managers were randomly selected from the Directory of HKCPAs and Directory of Investment Fund managers (Neidermeyer *et al.*, 1998; Umar and Anandarajan, 2004). Dijk (2000) suggests that to increase the response rate, potential participants should be contacted first by telephone to see whether they agree to complete the questionnaire (Shafer *et al.*, 2001), then, if they agree to participate, the questionnaires can be mailed to them. The fine-tuned questionnaire was thus sent to CPAs and fund amnagers who agreed to participate beforehand, and the completed questionnaires were then mailed to the researcher.

Research methodology and measurement

A mixed ANOVA was used (Gul, 1989; Patel and Psaros, 2000; Dijk, 2000) with two independent variables. Former auditors *from different non audit services (NASs) departments* variable has four levels, namely, compliance services, risk management, corporate finance, and transaction services (due diligence), and the time-lapse factor variable has two levels, namely, less than one year and more than one year. The dependent variable is perceptions of auditor independence, and the between-subjects independent variable is the Big 4 CPA group versus the fund mangers group.

The data were gathered using a questionnaire with a five-point Likert scale that was adapted from questions about scenarios developed in previous studies (Shockley, 1981; Pany and Reckers, 1987). Pre-tests in this study were found to be satisfactory. The CPAs and users rated their perceptions of auditor independence in the various scenarios on a scale ranging from 1 “seriously undermines independence” to 5 “strongly enhances independence.” Moreover, to minimize the “demand effect or learning effect” (Gul, 1989), a *randomized order of the scenarios* was used so that the respondents’ answers would not be affected by the demand effect or their familiarity with the flow of the questions (Pany and Reckers, 1980; Gul, 1989; Dijk, 2000). Demographic information on the respondents was captured in Part B of the questionnaire.

Results

There were 235 and 185 responses from the 350 questionnaires sent to the CPAs and fund managers, giving an overall response rate of 67% and 52% respectively. The items in the survey showed satisfactory levels of reliability, with a Cronbach’s alpha of 0.73 and a normal data distribution. A test for non-response bias was carried out by comparing the first 30 responses and the second 30 responses, respectively, for the two groups, but no significant differences in perceptions of independence were found. The sample comprised 208 females and 212 males. Forty-seven per cent of the respondents had 6-10 years of experience and 29% had 11-15 years of experience. The descriptive statistics for the means and standard deviations are shown in Table 2.

Table 2. Descriptive statistics

Time-lapse factor versus type of service	Type of sample	Mean	Std. Deviation	N
Less than 1 year with compliance services	Users	2.9730	1.33283	185
	Big 4	4.3617	.82756	235
	Total	3.7500	1.28024	420
Less than 1 year with risk management services	Users	2.8324	1.35495	185
	Big 4	4.3362	.79647	235
	Total	3.6738	1.31115	420
Less than 1 year with corporate finance services	Users	1.9027	1.12831	185
	Big 4	1.8128	1.13183	235

	Total	1.8524	1.12982	420
Less than 1 year with transaction services (due diligence)	Users	1.7297	1.02810	185
	Big 4	1.5447	1.00486	235
	Total	1.6262	1.01811	420
More than 1 year with compliance services	Users	3.6216	1.16915	185
	Big 4	4.7745	.62377	235
	Total	4.2667	1.07047	420
More than 1 year with risk management services	Users	3.5027	1.21192	185
	Big 4	4.6723	.78384	235
	Total	4.1571	1.15156	420
More than 1 year with corporate finance services	Users	3.2216	1.13232	185
	Big 4	3.6255	.89406	235
	Total	3.4476	1.02458	420
More than 1 year with transaction services (due diligence)	Users	2.9459	1.17829	185
	Big 4	3.5064	1.03927	235
	Total	3.2595	1.13599	420

Hypothesis 1

The multivariate test reported in Table 3 shows that the first within-subject independent variable – types of NASs departments – has an F value of 350 at $p < 0.05$. Green and Salkind (2001) recommend reporting the familiar Wilks' lambda value. The result is statistically significant, and thus H1 is supported. As the types of NASs departments variable is significant and has four levels, pairwise comparisons were undertaken using the Bonferroni comparison (Shannon and Davenport, 2001; Green and Salkind, 2001; Field, 2005) to reveal where the difference exists. Field (2005) suggests that Bonferroni's test controls the type 1 error rate very well, but is conservative. The pairwise comparison (Table 5) shows that all four types of NASs departments are significantly different from each other at a p value < 0.05.

Table 3. Multivariate Tests

Effect		F	Hypothesis df	Error df	Sig.
LAPSE	Wilks' Lambda	408	1	418	.000
LAPSE * TYPESAMP	Wilks' Lambda	2.6	1	418	.107
SERVICES	Wilks' Lambda	350	3	416	.000
SERVICES * TYPESAMP	Wilks' Lambda	58.4	3	416	.000
LAPSE * SERVICES	Wilks' Lambda	61.9	3	416	.000
LAPSE * SERVICES * TYPESAMP	Wilks' Lambda	12.9	3	416	.000

Design: Intercept+TYPESAMP.
Within-subjects Design: LAPSE+SERVICES+LAPSE*SERVICES.

Table 4. Means

SERVICES	Mean	Std. Error	95% Confidence Interval	
			Lower Bound	Upper Bound
Compliance	3.933	.039	3.856	4.009
Risk management	3.836	.040	3.757	3.915
Corporate finance	2.641	.036	2.570	2.711
Transaction services	2.432	.036	2.362	2.502

Table 5. Pairwise Comparisons

(I) SERVICES	(J) SERVICES	Mean Difference (I-J)	Sig.(a)	95% Confidence Interval for Difference(a)	
				Lower Bound	Upper Bound
Compliance	Risk management	.097(*)	.001	.028	.166
	Corporate finance	1.292(*)	.000	1.163	1.421
	Transaction services	1.501(*)	.000	1.376	1.626
Risk management	Compliance	-.097(*)	.001	-.166	-.028
	Corporate finance	1.195(*)	.000	1.072	1.319
	Transaction services	1.404(*)	.000	1.281	1.528
Corporate finance	Compliance	-1.292(*)	.000	-1.421	-1.163
	Risk management	-1.195(*)	.000	-1.319	-1.072
	Transaction services	.209(*)	.000	.134	.284
Transaction services	Compliance	-1.501(*)	.000	-1.626	-1.376
	Risk management	-1.404(*)	.000	-1.528	-1.281
	Corporate finance	-.209(*)	.000	-.284	-.134

Based on estimated marginal means.
* The mean difference is significant at the 0.05 level.
a Adjustment for multiple comparisons: Bonferroni.

The results are interesting. Compliance services have a mean score of 3.93, and risk management services have a mean score of 3.83 (Table 4), which implies that compliance services and risk management services enhance perceptions of auditor independence. In contrast, corporate finance services have a mean score of 2.64 and transaction services (due diligence) have a mean score of 2.43, which implies that both services undermine perceptions of auditor independence.

Hypothesis 2

The time-lapse factor (lapse) variable has an F value of 408 at $p < 0.05$, and thus H2 is supported. As the time-lapse factor is significant and has two levels, pairwise comparison using Bonferroni's test (Shannon and Davenport, 2001; Green and Salkind, 2001; Field, 2005) was again used to reveal where the difference exists. The pairwise comparisons in Table 7 show that both levels of the variable are significantly different from each other at a p value of < 0.05. A time lapse of more than one year has a mean score of 3.73, whereas a time lapse of less than one year has a mean score of 2.68 (Table 6). This implies that perceptions of auditor independence improve as the interval between the CPA departing from the audit firm and joining the audit client increases.

Table 6. Means

LAPSE	Mean	95% Confidence Interval	
		Lower Bound	Upper Bound
Less than 1 year	2.687	2.612	2.761
More than 1 year	3.734	3.659	3.809

Table 7. Pairwise Comparisons

(I) LAPSE	(J) LAPSE	Mean Difference (I-J)	Sig.(a)	95% Confidence Interval for Difference(a)	
				Lower Bound	Upper Bound
Less than 1 year	More than 1 year	-1.047(*)	.000	-1.149	-.945
More than 1 year	Less than 1 year	1.047(*)	.000	.945	1.149

Based on estimated marginal means.
* The mean difference is significant at the 0.05 level.
a Adjustment for multiple comparisons: Bonferroni.

Table 8. Tests of Within-Subject Contrasts

Source	LAPSE	SERVICES	Type III Sum of Squares	F	Sig.
LAPSE	Level 1 vs. Level 2		454.041	408.056	.000
LAPSE * TYPESAMP	Level 1 vs. Level 2		2.899	2.605	.107
SERVICES		Level 1 vs. Level 2	3.878	13.864	.000
		Level 2 vs. Level 3	591.524	660.069	.000
		Level 3 vs. Level 4	18.081	55.014	.000
SERVICES * TYPESAMP		Level 1 vs. Level 2	.450	1.607	.206
		Level 2 vs. Level 3	144.057	160.750	.000
		Level 3 vs. Level 4	.098	.297	.586
LAPSE * SERVICES	Level 1 vs. Level 2	Level 1 vs. Level 2	.313	.345	.557
		Level 2 vs. Level 3	467.528	158.268	.000
		Level 3 vs. Level 4	.221	.215	.643
LAPSE * SERVICES * TYPESAMP	Level 1 vs. Level 2	Level 1 vs. Level 2	.999	1.103	.294
		Level 2 vs. Level 3	70.957	24.020	.000
		Level 3 vs. Level 4	6.555	6.359	.012

Hypothesis 3

The multivariate test in Table 3 shows that the interaction between the time-lapse factor and type of services (lapse*services) has an F value of 61.9 at $p < 0.05$. The result is statistically significant, and thus H3 is supported. The mean score of the interaction is shown in Table 9. A time lapse of less than one year causes the largest drop in mean score, between risk management services and corporate finance services. The most significant results occur at level two and level three of the types of services, as shown in Table 8, that is, between risk management services and corporate finance services. When the time lapse is less than one year, there is a significant drop in the mean score of perceptions of independence between risk management services and corporate finance services. This conveys the message that independence is severely impaired when the switching CPA comes from the corporate finance department of the former audit firm.

Hypothesis 4

The interaction of the (lapse*typesample) variable has an F value of 2.6 at $p > 0.05$. The result is statistically insignificant, and thus H4 is rejected.

Hypothesis 5

The interaction of the (services*typesample) variable has an F value of 58.4 at $p < 0.05$. The result is statistically significant, and thus H5 is supported. As the result is significant, it is necessary to examine the means to determine where the difference lies. According to the test of within-subject contrasts in Table 8, the difference lies between level two (risk management services) and level three (corporate finance services). The mean score of services*typesample in Table 10 shows that the Big 4 CPA group gives a much higher mean score for risk management services (4.5) than the mean score given by the users (3.1). This may be the reason for the significant p-value in the tests of Hypothesis 5, and further implies that there may be an expectations gap between the Big 4 CPAs and the users. This is discussed in more detail in the discussion section.

Table 9. Means-LAPSE * SERVICES

LAPSE	SERVICES	Mean	95% Confidence Interval	
			Lower Bound	Upper Bound
Less than 1 year	Compliance	3.667	3.563	3.772
	Risk management	3.584	3.480	3.688
	Corporate finance	1.858	1.749	1.967
	Transaction services	1.637	1.539	1.735
More than 1 year	Compliance	4.198	4.111	4.285
	Risk management	4.088	3.991	4.184
	Corporate finance	3.424	3.326	3.521
	Transaction services	3.226	3.120	3.333

Table 10. Means-Types of samples * SERVICES

Types of samples	SERVICES	Mean	95% Confidence Interval	
			Lower Bound	Upper Bound
Users	Compliance	3.297	3.183	3.412
	Risk management	3.168	3.049	3.286
	Corporate finance	2.562	2.457	2.667
	Transaction services	2.338	2.233	2.443
Big 4	Compliance	4.568	4.466	4.670
	Risk management	4.504	4.399	4.610
	Corporate finance	2.719	2.626	2.813
	Transaction services	2.526	2.433	2.618

Hypothesis 6

The between-subject ANOVA reveals that the Big 4 CPA group versus the users group variable has an F value of 175 at $p < 0.05$ (Table 11). The result is statistically significant. There are also differences in the mean scores between the two groups. Table 12 shows that the Big 4 group gave a mean score of 3.58 and the users group a mean score of 2.84. Thus, the Big 4 CPAs have a significantly better perception of auditor independence than the users.

Table 11. Tests of Between-Subjects Effects

Source	Type III Sum of Squares	Mean Square	F	Sig.
Intercept	4267.1	4267.0	13290.3	.000
TYPESAMP	56.3	56.3	175.6	.000
Error	134.2	.3		

Table 12. Means

Types of samples	Mean	Std. Error	95% Confidence Interval	
			Lower Bound	Upper Bound
Users	2.84	.042	2.759	2.923
Big 4	3.58	.037	3.507	3.652

Discussion and implications

The result for H1 makes a contribution to the NASs literature. Most previous studies indicate that the provision of NASs has a negative influence on perceptions of auditor independence (Shockley, 1981; Hillison and Kennelley, 1988; Teoh and Lim, 1996; Beattie *et al.*, 1999; Gendron *et al.*, 2004; Lindberg and Beck, 2004; Chien and Chen, 2005; Alleyne *et al.*, 2006; Carey *et al.*, 2006; Richard, 2006). However, scant research has been conducted on the impact of the employment by clients of former auditors from different NASs departments on auditor independence. This study reveals that the direction of the relationship can be positive or negative. Where the type of service provided by a CPA in his or her former audit firm was a compliance service or risk management, and the CPA came from these departments and then later joined the audit client as an accounting or finance manager, perceptions of independence are enhanced. However, where the type of service provided by the CPA in his or her former audit firm was a corporate finance or transaction services (due diligence), and the CPA came from these departments and later joined the audit client as an accounting or finance manager, perceptions of independence are severely undermined. The results also show that when the CPA came from the transaction services department, perceptions of that CPA's independence decrease dramatically to a mean score of 2.4 (Table 4). This implies that the provision of compliance and risk management services may enhance auditor independence whereas the provision of corporate finance and transaction services undermines independence. The regulatory bodies and accounting associations could consider this research result in devising policy directions or drafting future ethical guidelines relating to CPAs seeking employment with former audit clients. These results indicate that not all NASs are detrimental to perceptions of independence, and it appears that compliance and risk management services are actually beneficial to the audit client. However, this study does *support* the earlier finding that NASs may increase the value of the auditor to the client (Goldman and Barlev, 1974; Gul, 1989). Further research needs to be conducted to validate this finding.

The hypothesis on the influence of the time-lapse variable (hypothesis 2) is also supported, and it is found that the longer the time lapse between the CPA departing the audit firm and joining the audit client, the higher the perceptions of auditor independence. A time frame of one year seems to be a reasonable time for independence to be preserved. Again, the regulatory bodies and accounting associations could consider this result in determining the direction of policy for the Hong Kong auditing profession.

The results for the tests of hypothesis 3 demonstrate that the two independent variables influence each other in exerting an effect on perceptions of independence. The influence of the former auditors coming from different NASs departments on perceptions of auditor independence depends on the time-lapse factor. With a time lapse of less than one year between a CPA leaving the audit firm and taking up employment with the client, there is a significant drop in the mean score of perceptions of independence between risk management and corporate finance services. This result suggests that independence is severely impaired when the CPA comes from the corporate finance department. Former auditors who work in the corporate finance or transaction services (due diligence) departments may have access sensitive and confidential business information in the course of the work, and hence affecting their perceived independence. Again, the regulatory bodies and accounting associations could use this information in setting auditing guidelines that restrict the employment of CPAs who formerly worked in the corporate finance or transaction services departments within a certain length of time.

Hypothesis 4, which posits that the influence of the time-lapse variable on perceptions of independence depends on the type of sample (interaction effect), is rejected because there are no significant differences in the ratings of the perceptions of independence between the two groups in relation to the time-lapse factor. In terms of hypothesis 5, there are significant differences in the ratings of the two groups of the effect of the types of NASs on independence, as shown in Table 3 and 10. The CPAs group rate auditor independence much higher than the users group, especially when the services provided are risk management services. Both groups perceive the provision of risk management services to enhance auditor independence, but the rating of the CPA group is significantly higher than that of the users group. This may be due to a gap in expectations, but future research is needed to validate this result.

Finally, in terms of hypothesis 6, there are differences in the perceptions held by the Big 4 CPA group and the users group, as shown in Table 11. The CPA group gives a much higher rating of independence at all levels than the users group. The users group does not perceive the employment of a CPA by a former audit client to be advantageous to the firm (mean score of 2.8), whereas the CPA group views such a move favorably (mean score of 3.5). This may again be due to an expectation gap, the existence of which could be validated by future research.

Conclusion

This study examines the perceptions of Hong Kong Big 4 CPAs and users of financial statements of the influence of the types of NASs and the time-lapse factor on the independence of auditors switching employment from the audit firm to the client firm. The results indicate that the former auditors from different NASs departments have an influence on perceptions of auditor independence, but that the direction of the relationship can be positive or negative depending on the types of services that were previously provided. The time lapse between a CPA leaving the audit firm and taking up employment with a client firm is found to influence the level of perceived auditor independence, with a time lapse of less than one year being considered to impair independence. The regulatory bodies and the HKICPA, among others, could consider these results in drafting future ethical guidelines relating to CPA employment with former audit clients. This study also shows that not all types of NASs are detrimental to perceptions of independence. Besides, the HKICPA could perhaps consider enacting a guideline similar to that in the United States of a mandatory one-year cooling off period before a member of the audit team can work for the client in certain key management positions. It is hoped that the results of this study will contribute to better financial reporting and audit quality so as to improve the confidence of the public in audits in the post-Enron climate.

This Hong Kong study is limited by sampling only Big 4 auditors and users. Future research could consider covering the perceptions of a wider group, such as non Big 4 auditors and accountants. Further research could also be conducted in other Asian countries, such as mainland China or Macau, to validate the findings identified in this study.

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Appendix -1

QUESTIONNAIRE

Part A

Type of services provided by the former CPA, with the time lapse factor: Less than one year

Scenario 1

Time lapse- Less than one year

Type of services provided by the CPA in his/her former CPA firm: Compliance services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *compliance services department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

Scenario 2

Time lapse- Less than one year

Type of services provided by the CPA in his/her former CPA firm: Risk management services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *risk management department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

Scenario 3

Time lapse- Less than one year

Type of services provided by the CPA in his/her former CPA firm: Corporate finance services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *corporate finance department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

Scenario 4

Time lapse- Less than one year

Type of services provided by the CPA in his/her former CPA firm: Transaction services (due diligence)

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is *the transaction services (due diligence) department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

<u>Type of services provided by the former CPA, with the time lapse factor: More than one year</u>

<u>Scenario 5</u>
Time lapse- More than one year

Type of services provided by the CPA in his/her former CPA firm: Compliance services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *Compliance services department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

<u>Scenario 6</u>

Time lapse- More than one year

Type of services provided by the CPA in his/her former CPA firm: Risk management services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *Risk management department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

<u>Scenario 7</u>

Time lapse- More than one year

Type of services provided by the CPA in his/her former CPA firm: Corporate finance services

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is the *corporate finance department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

<u>Scenario 8</u>

Time lapse- More than one year

Type of services provided by the CPA in his/her former CPA firm: Transaction services (Due diligence)

Please circle what you think the perceptions of auditor independence to be when the CPA comes from the department which is *the transaction services (due diligence) department*, and then now joins the audit client as the accounting / finance manager of the client.

Seriously undermines independence	Slightly undermines independence	No effect on independence	Slightly enhances independence	Strongly enhances independence
1	2	3	4	5

Part B

PERSONAL DATA

Please circle the appropriate answer.

Q1. 1. Male
 2. Female

Q2. Your age:

1. 20-25
2. 26-30
3. 30-35
4. 35-40
5. Above 40

Q3. How long are you working in this firm?
Please circle the appropriate period.

1. Less than 1 year
2. 1-5 years
3. 6-10 years
4. 11-15 years
5. More than 15 years

(Answer by Big 4 auditors only)

Q4. Generally, Big 4 firm staff have the following job titles from the lowest to the highest. Please circle which best describes your position in your firm:

1. Staff Auditor
2. Senior
3. Manager
4. Senior Manager
5. Partner